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UPDATE

Deadlock revisited in *Chu v Lau*: Winding-up on the Just and Equitable Ground

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The jurisdiction to wind up a British Virgin Islands (**BVI**) company on the just and equitable ground is well trodden; the statutory remedy contained in the BVI Insolvency Act, 2003 (the **Act**) closely follows the similar jurisdiction in the United Kingdom. In the recent decision of *Chu v Lau*[1] the Privy Council has reconfirmed the application of the well-known and long standing principles expressed in *Ebrahimi v Westbourne Galleries Ltd (In re Westbourne Galleries Ltd)*[2] to the assessment of whether a company is to be considered a quasi-partnership such that members' strict legal rights are subject to equitable considerations.

Background

The respondent (**Mr Chu**) and the appellant (**Mr Lau**) were experienced Hong Kong based businessmen who had previously enjoyed joint commercial success in the shipping and logistics industries. In November 2009, Mr Chu and Mr Lau entered into a joint venture with a Chinese state-owned entity, Beibu Gulf Ocean Shipping (Group) Ltd (**Beibu Gulf**) for the intended business of ship-owning, commodity trading and supply chain services for dry bulk commodities (the **Joint Venture**). The parties' Joint Venture interests were held through two corporate vehicles, Ocean Sino Ltd (**OSL**), a BVI company in which they each owned one of the two issued shares, and PBM Asset Management Ltd (**PBM**), a Hong Kong company and wholly owned subsidiary of OSL. The Joint Venture formed part of the broader business relationship between the businessmen and for a number of years, the parties continued to enjoy a constructive business relationship.

In May 2015, and as a result of a breakdown of relations between the parties, Mr Lau applied to the BVI High Court for the winding-up of OSL on just and equitable grounds alleging that the trust and confidence between the parties had irretrievably broken down and that there was a functional deadlock in the management of OSL (and therefore PBM). The trial judge granted the winding-up order sought and appointed liquidators to OSL. Mr Chu appealed and the Court of Appeal unanimously reversed the first instance decision and discharged the winding-up order on the basis that there had been no deadlock and winding-up was not an appropriate remedy. The Court of Appeal held that the trial judge had made the following errors: (i) he had wrongly considered deadlock at Beibu Gulf level in assessing whether there was deadlock in OSL, (ii) the relevant time for determining deadlock in OSL was at the date of the filing of the application as opposed to the time of the hearing, (iii) he failed to consider the freedom the businessmen had to sell their shares in OSL as a means of avoiding deadlock, and (iv) there were alternative remedies available to Mr Lau, such as a buy-out, before ordering a winding-up as a remedy of last resort.

[1] [2020] UKPC 24, judgment delivered on 12 October 2020.

[2] [1973] AC 360.

Just and Equitable: when is winding-up appropriate?

Mr Lau succeeded in his appeal to the Privy Council and the Board reinstated the winding-up order, holding that "...this was a paradigm case of breakdown in trust and confidence in a quasi-partnership company, and of functional deadlock, for either of which winding-up is the typically appropriate remedy provided by statute"[3].

Taking each of the purported errors identified by the Court of Appeal in turn, the Board held as follows:

(a) In assessing deadlock, although it is the management of the company sought to be wound up (OSL) that must be addressed, "*...the breadth of the parties' falling out over other business matters may be very relevant to the court's assessment of the question whether an apparent deadlock within the subject company has become irremediable*"[4].

(b) Following *Ebrahimi*, when determining the relationship between quasi-partners and the extent to which trust and confidence between partners has evaporated, "*...no aspect of their business relationship is likely to be irrelevant*"[5]; on the facts, it was appropriate for the trial judge to assess deadlock by taking into consideration the management of the affairs of PBM as a wholly owned subsidiary of OSL but also the manner in which the conduct of the affairs of Beibu Gulf had taken place. Mr Lau and Mr Chu were both directors of Beibu Gulf on the nomination of PBM.

(c) As to the relevant time for determining deadlock in OSL, there is no rule of law requiring an application for winding-up on the just and equitable ground to be justified solely by reference to the position of the parties as at the date of the filing of the application. Section 162(1)(b) of the Act is couched in the present tense, so the court must determine at the time of the hearing whether it is just and equitable that a liquidator should be appointed. There is no requirement in the Act or the Insolvency Rules, 2005 to ignore relevant evidence filed after the making of the application and it follows that the court should consider all relevant matters as at the date of the hearing[6].

(d) On the ability of Mr Lau to avoid deadlock by selling his shares, although "*...there was (perhaps unusually) no restriction in the Articles of Association of OSL against dealings by each member with his shareholding*"[7] such that Mr Lau was in theory "*...free to disengage from his association with Mr Chu*"[8], in the Board's view, this would only be an answer to a case of functional deadlock if that member "*...could be expected to be able to [sell] upon fair terms*"[9]. There were a number of practical hurdles in the way of Mr Lau divesting himself of his shares on fair terms to any incoming purchaser such that his freedom to sell was purely theoretical and therefore appropriately discounted by the trial judge.

(e) As for alternative remedies, section 167(3) of the Act provides that a respondent to a just and equitable winding up application may resist it by demonstrating "*...that some other remedy is available to the applicant and that he is acting unreasonably in seeking to have a liquidator appointed instead of pursuing that other remedy*". The Board held that the Court of Appeal misdirected itself when it took the view that it was for Mr Lau and not Mr Chu to demonstrate that there was no alternative remedy reasonably available to him. Moreover, the Board held that the trial judge appropriately considered alternative shareholder remedies and determined that it was not unreasonable for Mr Lau to pursue a winding up of OSL.

Four additional points were raised by Mr Chu in support of the decision of the Court of Appeal that the Board held *"neither singly nor in the aggregate....amount*[ed] *to a basis for upholding the order of the Court of Appeal*"[10].

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[3] [2020] UKPC 24 at [59].

[4] *Ibid* at [23].

[5] *Ibid* at [25].

[6] *Ibid* at [43].

[7] *Ibid* at [48].

[8] *Ibid*.

[9] *Ibid* at [49].

[10] *Ibid* at [68].

Lady Arden delivered a separate judgment, agreeing that the appeal should be allowed but not merely on the ground of functional deadlock between the businessmen but also on the ground that Mr Lau had been wrongly excluded from participation in the management of OSL, its subsidiaries and affiliates. Her Ladyship's judgment focused on factual allegations made by Mr Lau as to his exclusion from management and which the trial judge found proved, holding that "*...deadlock is the symptom and consequence of a more fundamental malaise; namely that of exclusion by Mr Chu of Mr Lau from management participation*"[11]. Her Ladyship further opined if "*...the Court of Appeal had not been misled into thinking that they could not rely on matters occurring after the commencement of the proceedings, they would in my judgment have had to deal with the impact of the* [trial] *judge's findings on exclusion. If they stood, it is difficult to see how the judge's order could have been set aside*"[12].

Conclusion

The decision serves as a reminder that each application to appoint a liquidator on the just and equitable ground will turn on the relevant facts and the general principles established in *Ebrahimi* should not be stymied by reference to previous cases in which a winding-up order has been made. An appellate court should be slow to overturn such factual decisions made by a court of first instance with the benefit of hearing evidence first-hand and upon which that court exercised its discretion.

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[11] *Ibid* at [85].

[12] *Ibid* at [95].